

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 03 TAIPEI 003799

SIPDIS

DEPT PASS TO AIT/W AND USTR
DEPT FOR EAP/TC, EAP/EP AND EB/IFD/OIA
TREASURY FOR OASIA ZELIKOW, WISNER AND OCC AMCAHON
TREASURY ALSO PASS TO FEDERAL RESERVE BOARD OF GOVERNORS,
SAN FRANCISCO FRB AND NEW YORK FRB

E.O. 12958: DECL: 09/08/2020

TAGS: [ECON](#) [EINV](#) [PINR](#) [PREL](#) [TW](#) [CN](#)

SUBJECT: EVOLVING TAIWAN ROLE IN GREATER CHINA ECONOMY

Classified By: AIT ACTING DIRECTOR DAVID KEEGAN, REASON 1.5 B/D

1. (C) Summary: A number of forward-looking Taiwan business people see that Taiwan's economy is in the midst of another major shift in its evolution from manufacturing toward a service and knowledge-based economy. While other Pacific Rim economies are becoming big players in venture capital in China, Taiwan businesses are discovering a unique mentoring role in coordinating China's emergence as a global economic power. Taiwan's visionaries see that contrary to the common perception, Taiwan wields considerable influence in China in commerce and in economic policy. China is to a large extent modeling its economic policies on the export-led development strategy that created the Taiwan "economic miracle" of development in the 1970's and 80's. Taiwan is not just inspiring, but also investing: over 70 percent of China's high-tech exports come from Taiwan-invested factories, and over two-thirds of Taiwan's foreign direct investment goes to China. Former Acer Group Chairman Stan Shih's establishment of iD Softcapital in January 2005 creates a new, key role for Taiwan in fostering start-up companies in Greater China by using Taiwan's strength in understanding international trade logistics to supplement China's shortcomings in this area. End Summary.

Asian Venture Capital Plays Major Role in China

2. (C) The media has recently reported the role played by venture capitalists from Pacific Rim countries in the formation of start-up companies in China. Hong Kong-based venture capital firm Softbank Asia Infrastructure Fund (SAIF) Partners has earmarked about 70 percent of its US\$404 million SAIF for China. SAIF executives claim the company's annual return of 97 percent over the past three years is based on its strong network of local contacts in China unearthing investments that the "fly-in" venture capitalists from Silicon Valley have difficulty finding. Silicon Valley-based H&Q Asia Pacific is also dismissive of "venture capital tourists" and considers the Asian origin of its top executives as crucial in its 19 years of successful investments in start-up companies in East Asia. H&Q has invested about US\$250 million in Chinese companies and indicates that amount is likely to grow quickly in the future.

Taiwan's Investors Conservative

3. (C) Although Taiwan is a major investor in China, and Taiwan capital plays a crucial role in China's export industries, relatively little of this investment goes to Chinese start-up companies. From his vantage as a consultant to small and medium size Taiwan investors, Crystal Capital Managing Partner Peter Shen (Pei-ling) told AIT there are few real venture capitalists left in Taiwan. The bursting of the dot.com bubble soured many investors on high-risk projects, after which there were increased cross-Strait tensions and the new Taiwan tax law which removed exemptions for investments in start-up companies. Weak stock market performance and low P/E ratios have further dampened Taiwan venture capital activities in recent years.

4. (C) Shen said he has clients who claim to be venture capitalists, but when he presents them with opportunities involving high tech start-up companies in China with great potential returns but also great risk, they find a reason not to invest, often citing a lack of technical expertise. However, these self-described venture capitalists are very interested when Shen shows them a conservative manufacturing investment with a small but safe rate of return. Shen described the typical Taiwan small investor as having a conservative middle-class point of view and not willing to take much risk. He noted that many of Taiwan's larger venture capital firms receive money from government funds, such as the Executive Yuan's Development Fund, and are prohibited or discouraged from investing in China. Even the Taiwan venture capital firms without government funds face restrictions on the types of investments they can make in China, and are encouraged to invest elsewhere.

Taiwan Money Not At Home

15. (C) Shen also commented on the tendency of Taiwan capital owners to keep their money offshore. He estimated that Taiwan-owned capital made up 25-40 percent of the capital in Hong Kong hedge funds. Shen believed there has been a large-scale exodus of Taiwan businesses and capital owners from Taiwan in recent years to seek better investment and business opportunities in other parts of Greater China, which he defined as including China, Hong Kong, Macau, Taiwan, Singapore, and all the Southeast Asian economies dominated by ethnic Chinese. He thought this had led to the development of a loosely affiliated international business network of capitalists and business people that had a Taiwan link, but which did not necessarily maintain any formal ties with Taiwan such as citizenship or business registration. Shen noted that Taiwan expats had also become prominent in other parts of the world.

16. (C) Merrill Lynch Taiwan Director Sophia Cheng also described to AIT the widespread reluctance of Taiwan capital owners to repatriate earnings or keep investments in Taiwan. Cheng saw Taiwan's inheritance and gift taxes of up to 50 percent as a major factor encouraging wealthy residents to park assets off-island, and noted that many of her clients have moved money to Hong Kong because it lacks these taxes. Further, Taiwan does not tax overseas income and is blocked from doing so by the lack of tax treaties between Taiwan and all but 15 other countries.

17. (C) Investments by Taiwan venture capital firms in 2005 were only about half the level they reached in 2000. Merrill Lynch Director Cheng noted that the poor venture capital market in Taiwan in recent years resulted from capital flowing out of Taiwan due to concerns about the cross-strait political situation from 2000-2004. She also mentioned that the number of companies listing on the Taiwan stock exchange had averaged over 100 per year for the past four years, and price/earnings ratios declined to 13 or 14:1, lower than other regional markets. The relatively low price/earnings ratio in turn discouraged venture capital firms from investing in start-up companies. Many venture capital firms switched their focus to private placements or mergers & acquisitions.

The Greenwich Village of Greater China

18. (C) In spite of his perception of large-scale business flight from Taiwan, Shen still saw Taiwan as the most livable place in Greater China because of its relatively free press, liberal policies and attitudes, and creative orientation. Shen thought these attributes gave reasonable assurance of Taiwan's continued prosperity by being a creative center for all of Greater China. As an example, he cited the popularity of Taiwan pop music and soap operas in other parts of East Asia.

New approach

19. (C) iD SoftCapital was established by Acer Founder Stan Shih in January 2005 shortly after Shih's formal retirement as Chairman of the Acer Group. The company manages about US\$460 million in funds, out of which a venture capital fund of about US\$370 million is dedicated to the development and expansion of start-up companies. The remaining funds are used in iD SoftCapital's consulting and re-structuring operations. iD SoftCapital Group Chairman and General Partner William Lu (Hung-i) met with AIT/Econ on August 29 to discuss his company's approach toward Taiwan participation in international venture capital opportunities.

Key Taiwan Role in Greater China

10. (C) According to Chairman Lu, iD SoftCapital's primary mission is to offer expertise in asset and fund management, and "intellectual development for the new economy." He described iD SoftCapital as an "integrator" that brings together various essential business resources from the "global Chinese community." Lu said iD SoftCapital has a very different approach from other Taiwan venture capital companies. It is not seeking investors from Taiwan, instead it will integrate Chinese management and marketing skills from Taiwan, capital, and technology from Chinese communities in the United States and Europe, with the manufacturing ability of China to promote Greater China's (which Lu defined as Hong Kong, Taiwan, and China) economic development.

11. (C) Chairman Lu said that at present, about 60 percent of iD SoftCapital's investment is in Taiwan and about 30 percent in China. The company will gradually increase the proportion of its investment in China to 50 percent over the next three years. During this period it will gradually shift

its staff from Taiwan to Shanghai.

12. (C) Lu noted that some other Taiwan companies are trying to adopt a similar strategy to take advantage of the demand and opportunities for venture capital in China.

13. (C) Echoing Lu's and Shen's comments, Matthew Miao, Chairman of Mitac, which makes PCs, servers and mobile communications devices in Taiwan, Guangzhou, China and Jiangsu, China, told AIT on September 6 that Taiwan's greatest strength is to be a "business integrator." He said Taiwan has already moved from a manufacturing powerhouse exemplified by the term "made in Taiwan" to a coordinating role best explained as "made by Taiwan." He sees Taiwan's future growth tied to a strategy of bringing Taiwan's managerial, marketing and logistical strengths together to run multinational efforts to research, design, produce, distribute and retail products.

Taiwan Helps China Modernize Economy and Laws

14. (C) AIT contacts note that Taiwan's mentoring of China goes well beyond the commercial realm into economic policy areas. Local contacts claim that people from Taiwan currently enjoy widespread respect and admiration in China. Taiwan lawyers have played a significant role in advising and drafting China's commercial law, and native Taiwanese have become senior economic advisors to the PRC Government. Even China's overarching strategy of export-based economic growth is to some extent modeled on Taiwan's success with that strategy as the basis for its "economic miracle" of the 1970's and '80's. Taiwan is not just inspiring, but also investing: over 70 percent of China's high-tech exports come from Taiwan-invested factories, and over two-thirds of Taiwan's foreign direct investment goes to China. Economists estimate that the total cumulative Taiwan investment in China is over 10 times the total U.S. investment of US\$10-12 billion. Former Acer Group Chairman Stan Shih's establishment of iD Softcapital in January 2005 creates a new, key role for Taiwan in fostering start-up companies in Greater China by using Taiwan's strength in understanding international trade logistics to supplement China's shortcomings in this area.

15. (C) Comment: AIT contacts have observed that Taiwan's greatest potential contribution to the economic development of Greater China is its knowledge of international business practices and global logistics. If iD SoftCapital can succeed in its vision of managing Taiwan's strengths as an integrator with other essential business components from around the world, the resulting synergies could lift the economic integration of Greater China to an even higher level. China's respect for Taiwan encompasses Taiwan's legal and economic systems as well as its artistic and cultural products such as popular music and television. While Taiwan often laments its lack of influence over China's policy towards Taiwan, it is, in fact, exerting an enormous influence in China's economic development, and in China's economic, legal, civil, material, and cultural aspirations. End Comment.

KEEGAN